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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
2 June 1967

INTELLIGENCE MEMORANDUM

The Effect of the Cultural Revolution
on Communist China's Foreign Trade

Summary

The cultural revolution in Communist China has not yet had an appreciable effect on the volume and pattern of

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So far in 1967, the effects of the revolution on trade appear limited to remittances and a possible tightening in export supplies of chemicals and textiles. Early returns on trade in 1967 from seven of China's major Free World trading partners indicate that China's exports to these countries increased by a respectable 10 percent. A continuation of the revolution at its present pace, however, would gradually impair export capabilities, increase the need for imports of grain, and, in general, increase the importance of Free World trade and credits.

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Background

1. The cultural revolution broke out in the open in late 1966, spilled over into the economy in August 1966 with the appearance of the militant Red Guards, and was formally extended to factories and farms in December 1966. The regime almost immediately had to remedy the resulting excesses, but in spite of calls for both "production and revolution," political turmoil has continued to affect the orderly operation of the economy during 1967.

2. The effects of the cultural revolution on the Chinese economy were first apparent in the last quarter of 1966 when industrial production began a gradual decline. This decline has carried over into the first half of 1967. Agriculture has also been subject to disruptions, although the extent of the damage waits on an assessment of the forthcoming spring harvests.

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3. Many of the effects of the cultural revolution on foreign trade will lag behind the general economic effects, for example, the gradually reduced capabilities of export industries. An immediate effect of the revolution is confusion in the planning of foreign trade and delay in negotiation for purchases of foreign machinery and foodstuffs. However, this effect will not be reflected in current foreign trade data which, of course, deal with completed shipments of goods rather than with inquiries and contracts for future delivery. A third effect on foreign trade -- shifts in the composition and geographical distribution of trade -- also will be reflected only after a considerable period of time.

Jump in Trade in 1966

4. Communist China's foreign trade grew by an estimated 12 percent in 1966, to \$4.2 billion compared with \$3.8 billion in 1965, as indicated in Table 1. This

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substantial increase followed two years of even sharper rises (averaging 18 percent) and reflected the continuing recovery of the Chinese economy from the near-disastrous Leap Forward. The annual data for 1966 could of course mask difficulties occurring in the final quarter. However, all of the available evidence relative to foreign trade activity supports the general conclusion that the cultural revolution during this period did not significantly disrupt Chinese Communist foreign trade.

Continued Shift to Free World

5. China's trade with the Free World rose by an estimated 13 percent in 1966, whereas trade with Communist countries fell off by perhaps 4 percent. Consequently, the Free World's share in China's trade rose to 73 percent. Japan strengthened its lead as China's major trading partner and now accounts for one-seventh of China's total trade. Hong Kong took over second place

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from the USSR, although practically all Hong Kong's trade is one way, i. e., imports from China. (Table 2 presents the volume of China's trade with leading partners for 1965 and 1966.)

6. Among Western European countries, West Germany and France moved ahead of the United Kingdom in 1966 as the leading sources of Chinese imports. Trade with South and Southeast Asia and the Middle East rose moderately during the year while trade with Latin American countries showed little change. After a sharp rise in 1965, trade with African countries declined in 1966, apparently because of China's setbacks in foreign policy in that area. Sino-Soviet trade fell by 23 percent, to the lowest level since 1950. Deliveries by China to North Vietnam rose to \$95 million in 1966, compared with \$70 million in 1965.

Grain Imports Down, Machinery Up

7. China's imports of grain declined from 6.2 million tons to about 5.8 million tons in 1966. In contrast, China

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increased imports of machinery, fertilizer, and finished steel. There was a sharp rise in imports from Japan and Western Europe of machinery, equipment, and scientific instruments that play an important role in China's modern weapons programs.*

Commodity Composition of Imports a/
1965-66

	Million US \$	
	<u>1965</u>	<u>1966</u> b/
Total	<u>1,860</u>	<u>2,045</u>
Agricultural products	<u>760</u>	<u>730</u>
Grain	400	390
Industrial materials	<u>590</u>	<u>685</u>
Fertilizers	145	180
Machinery and equipment	<u>355</u>	<u>450</u>
Other imports	<u>160</u>	<u>180</u>

- a. Data are rounded to the nearest \$5 million. Because of rounding, components may not add to the totals shown.
b. Preliminary estimates.

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Agricultural Exports Rise

3. China's sales of foodstuffs and various crude agricultural products increased markedly in 1966. Other categories of exports showed smaller gains. Textile sales may have continued to decline in 1966, again because of reduced sales to the USSR.

Commodity Composition of Exports a/
1965-66

	Million US \$	
	1965	1966 <u>b/</u>
Total	<u>1,905</u>	<u>2,155</u>
Agricultural products	<u>835</u>	<u>1,010</u>
Foods	545	630
Industrial materials	<u>290</u>	<u>330</u>
Textiles	<u>425</u>	<u>400</u>
Other manufactured goods	<u>355</u>	<u>415</u>

a. Data are rounded to the nearest \$5 million.
Because of rounding, components may not add to the totals shown.

b. Preliminary estimates.

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Drop in Overseas Remittances

9. The only direct impact of the cultural revolution on the balance of payments noted in 1966 was the sharp cutback in overseas remittances in the last four months of 1966. As a result, remittances for the year reached only an estimated \$43 million compared with \$60 million for 1965. A plus factor was the switch in the trade balance with the Free World, from a deficit in 1965 to a small surplus in 1966. The export surplus in China's trade with Communist countries declined principally because China's trade balance with the USSR reversed from an export surplus in 1965 to an import surplus in 1966.

Credit Situation

10. Because of China's conservative policies and reluctance to depend on foreign assistance, all of the credits thus far have been short-term. As a result,

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China has been faced with a large volume of repayments each year, and in 1966, when a large repayment on grain credits fell due, payments probably equalled or exceeded drawings. Long-term credits which would defer repayments for ten or more years would be more to China's advantage. The leadership, however, has a practical concern for the long-run payments position and especially for the possibility that requirements for Western grain may rise in the near future. Should China reverse its position and seek long-term credits, Western European countries and Japan probably would make such credits available. The cultural revolution apparently has not jeopardized China's ability to obtain long-term credits, but admittedly the willingness of Free World nations to advance large credits has not really been put to the test.

Trade Developments in 1967

11. Early returns for 1967 are available from seven of China's trading partners, which accounted for about

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61 percent of China's exports to and 54 percent of China's imports from the Free World in 1966. As shown in Table 3, China's imports from these countries declined by 2 percent, while exports to these countries increased by 10 percent, compared with the same period in 1966. While no broad conclusions can be drawn from these incomplete data, the cultural revolution apparently has had only a slight effect on China's trade with its principal Free World trading partners in the first quarter of 1967.

12. Trade agreements concluded during late 1966 and the first four months of 1967 do not indicate substantial changes in China's 1967 trade, and, despite some difficulties during January and February, contracts with Western businessmen are now being placed at a normal pace. Contracts concluded at the annual Canton Trade Fair in April 1967 appear to have reached the levels of previous years. The recent disturbances in Hong Kong have not so

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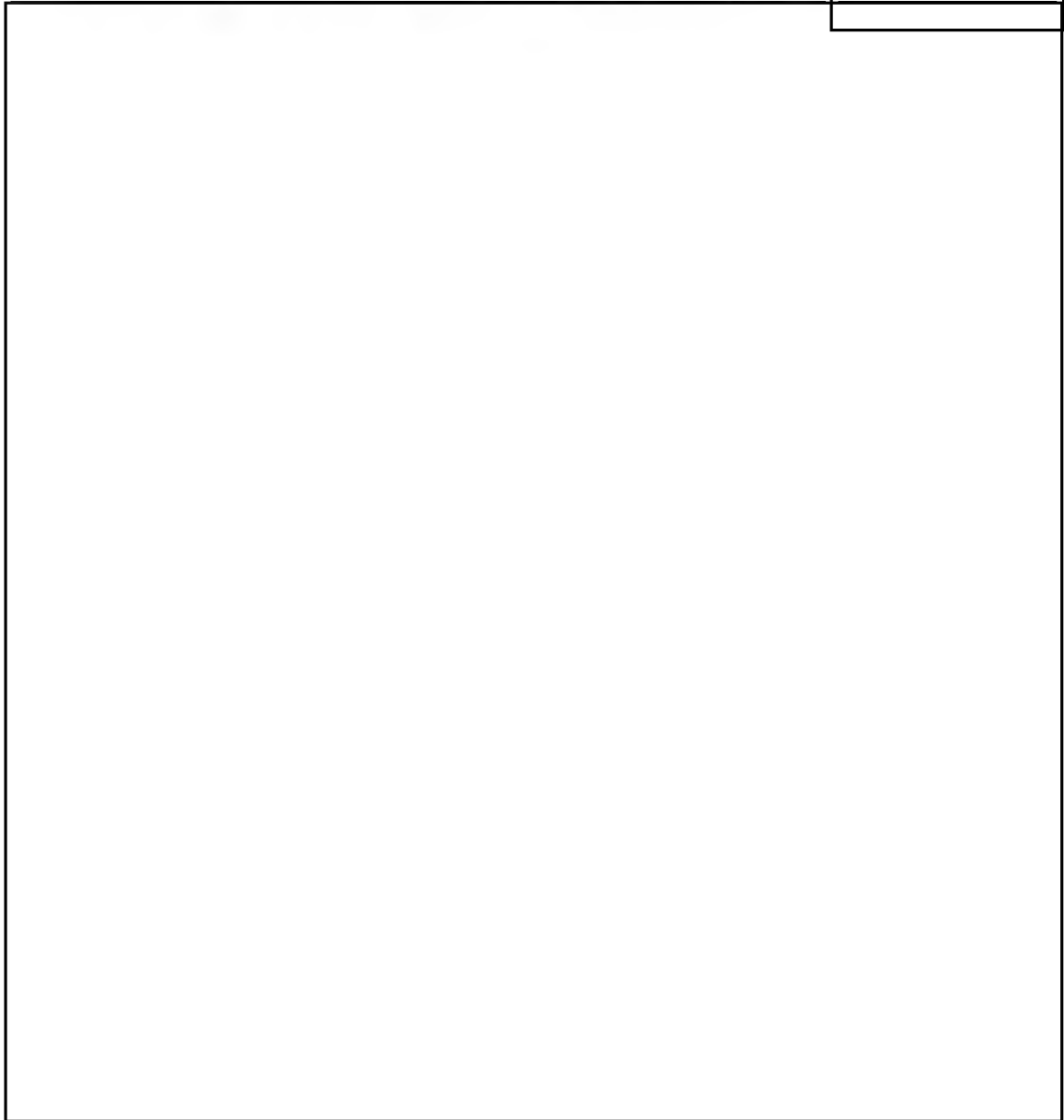


far had feedback effects on the mainland economy;



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Share and Composition of Trade in 1967

14. The Free World share of China's trade probably will grow slightly in 1967 because of growth in trade with the countries of Western Europe and a further reduction in Sino-Soviet trade. Sino-Japanese trade probably will not continue the rapid growth of the past few years because Japanese markets cannot readily absorb additional Chinese goods.

15. The composition of China's trade in 1967 is not expected to show substantial changes over 1966. Grain contracts for the first six months are down slightly, compared with the same period in 1966. The volume of fertilizer contracted for in 1967 is more than 50-percent higher than 1966 purchases; however, as a result of shrewd Chinese bargaining with Western European and Japanese producers, the value of these fertilizer contracts is only slightly higher than the estimated value of \$180 million for 1966 imports. Orders

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placed during 1966 for the whole plant and other capital equipment to be delivered in 1967 and later were substantially lower than during the previous two years. Negotiations for the DEMAG steel complex were suspended during the last half of 1966 and did not resume until April 1967. Machinery and equipment imports in 1967, however, are expected to increase over 1966 on the strength of orders placed during 1965. Early contracts with Japan and early trade returns from a few Western European countries indicate a probable slowdown in the growth of China's agricultural exports during 1967.

No Immediate Economic Crisis

16. There is now very little evidence of forward movement in the Chinese Communist economy and some indication of a gradual decline in economic efficiency. During April and May, political turmoil associated with

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the cultural revolution continued to interfere with the orderly operation of the Chinese economy. The excesses of the revolution, which threatened serious economic dislocations in early 1967, have been largely brought to an end, but administrative confusion and sporadic disruptions to industry and transport continue to plague the economy. Even though the decline in industrial production noted in the fourth quarter of 1966 and the first quarter of this year will probably continue at least through mid-1967, there does not appear to be any danger of an immediate economic crisis. The revolution appears to have had no effect on agriculture in 1966 and its effects in 1967 will be difficult to assess until harvest time early this summer.

Prospects

17. There appear to be three general courses which the cultural revolution could take in the near future. If

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the revolution were to intensify and result in lengthy disorders on the scale of the excesses of January 1967, the effects on foreign trade would be immediate. Production and shipment of Chinese goods for export would sharply decline, and imports arriving in Chinese ports would only slowly move on to consignees. The leadership at present appears to be unwilling to allow such an intensification, largely because of the January 1967 experience.

13. If the leadership decided to drop the priority now accorded to the cultural revolution and return to the more pragmatic policies of 1961-65, it is possible that there would be little discernible effect on the patterns of foreign trade. In effect, neither the excesses of the turn of the year nor the drift which has marked the economy since that time would have been great enough to disturb the patterns of foreign trade. However, we think it unlikely that Mao Tse-tung would accept the repudiation of his personal views implied by such a shift of policy.

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19. A third course lies in a continuation of present trends in the economy. There appears to be a general lack of momentum in the economy, preliminary signs of a gradual decline in industrial production, very faint signs of problems in agricultural production, and good signs that the administrative gears are not meshing with their former precision. The regime shows no indication of taking measures to meet these problems, and in the near-term it is likely that a gradual and almost imperceptible economic decline may occur. Under these conditions, the existing Chinese problem with increasing export capabilities would be exacerbated as industrial production and, perhaps, agricultural production declined below the levels of previous years. The resulting contradiction in Chinese exports would lead to decreases in Chinese imports of machinery and equipment from the Free World. If serious shortfalls occurred in agricultural production, Free World

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grain and fertilizers could become the main component of Chinese imports. Nevertheless, these postulated effects of the cultural revolution on foreign trade are likely to appear only gradually, perhaps over a period of one or more years.

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Table 1

Communist China: Foreign Trade by Area a/
1965-66

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	1965			1966 <u>b/</u>		
	Turnover	Imports	Exports	Turnover	Imports	Exports
Total	<u>3,765</u>	<u>1,860</u>	<u>1,905</u>	<u>4,200</u>	<u>2,045</u>	<u>2,155</u>
Free World Countries	<u>2,605</u>	<u>1,345</u>	<u>1,255</u>	<u>3,085</u>	<u>1,530</u>	<u>1,555</u>
Western Europe	645	345	300	900	510	390
Japan	470	255	215	620	330	290
Canada, Australia, New Zealand	360	315	45	340	285	55
South and Southeast Asia	390	155	235	435	170	265
Hong Kong <u>c/</u>	310	5	310	380	5	375
Middle East	150	80	70	170	75	95
Africa	160	75	90	135	50	85
Latin America	115	115	Negl.	105	105	Negl.
Communist Countries	<u>1,165</u>	<u>515</u>	<u>650</u>	<u>1,115</u>	<u>515</u>	<u>600</u>
USSR	415	190	225	320	175	145
Eastern Europe <u>d/</u>	200	105	95	255	130	125
Far East	230	90	140	265	95	170
Other <u>e/</u>	315	125	190	275	115	160

a. Data are based on the official statistics of the trading partners, where known, and have been adjusted to approximate Chinese foreign trade on an export f.o.b. and an import c.i.f. basis. Data have been rounded to the nearest \$5 million and, because of rounding, components may not add to the totals shown.

b. Preliminary estimates.

c. Net of entrepot trade with third countries.

d. Excluding Yugoslavia and Albania.

e. Including Albania, Cuba, Mongolia, and Yugoslavia.

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Table 2

Communist China: Trade with Major Partners a/
1965-66

Major Partners	Million US \$					
	1965			1966 <u>b/</u>		
	Turnover	Imports	Exports	Turnover	Imports	Exports
Japan	470	257	213	622	331	291
Hong Kong <u>c/</u>	312	3	308	378	3	375
USSR	415	190	225	320	175	145
West Germany	137	72	65	216	135	81
Canada	131	118	13	214	196	18
United Kingdom	152	75	77	178	96	82
Malaysia and Singapore	103	2	101	174	47	127
France	102	63	39	159	111	48
Italy	87	53	34	110	61	49
Australia	219	189	30	106	83	23

a. Data are based on the official statistics of the trading partners and have been adjusted to approximate Chinese foreign trade on an export f.o.b. and an import c.i.f. basis. Data have been rounded to the nearest \$1 million.

b. Preliminary estimates.

c. Net of entrepot trade with third countries.

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Table 3

Communist China: Trade with Major Partners
for 1967 and Comparable Months for 1966 ^{a/}

Million US \$

Country	Period	Imports			Exports		
		Value		Percentage Change	Value		Percentage Change
		1966	1967		1966	1967	
Japan	Jan-Mar	76.2	49.0	-36	66.6	69.5	4
Hong Kong ^{b/}	Jan-Mar	0.7	0.4	-43	101.0	129.0	28
West Germany	Jan-Feb	16.8	30.6	82	14.6	12.6	-14
United Kingdom	Jan-Feb	13.1	13.1	0	19.8	16.2	-18
France	Jan-Feb	11.2	12.0	7	9.0	8.9	-1
Italy	Jan	6.4	7.6	19	3.7	3.7	0
Australia	Jan	6.8	15.7	131	5.2	3.0	-42
Total		<u>131.2</u>	<u>128.4</u>	<u>- 2</u>	<u>219.9</u>	<u>242.9</u>	<u>10</u>

a. Data are the official statistics of the trading partners.

b. Export data include Chinese goods reexported by Hong Kong to third countries. The growth rate in exports may be inflated by changes in Hong Kong's reporting system.

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